

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 17986
[Redacted]	)	
	)	DECISION
Petitioner.	)	
_____	)	

On January 30, 2004, the Income Tax Audit Bureau (Bureau) of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer), proposing denial of a refund of Idaho individual income tax in the amount of \$7,331 for tax year 2002.

The taxpayer filed a timely protest and petition for redetermination. The taxpayer did not request a conference and did not submit additional information. The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision.

The taxpayer filed her 2002 Idaho individual income tax return on or about April 15, 2003, and submitted an amended Idaho return for the same year on or about September 24, 2003. Upon receipt of the amended return, both the original Idaho return and the amended Idaho return were referred to the Bureau for review.

The Bureau determined the reduction in taxable income shown in the amended return should not be allowed and sent the taxpayer a notice of the determination. The taxpayer appealed the Notice of Deficiency Determination (NODD) and her file was transferred to the Legal/Tax Policy Division for administrative review. The taxpayer did not respond to a letter outlining her right to request a hearing or submit additional information.

The taxpayer received a lump sum settlement from an employer discrimination lawsuit in January 2002. She timely filed her 2002 federal and state tax returns reporting the full settlement

amount as taxable income and paid the appropriate taxes. In September 2003, the taxpayer filed a 2002 Amended Idaho Individual Income Tax Return claiming half of the settlement amount as non-taxable. In the explanation of the change to income, her accountant referenced Internal Revenue Code § 104(A)(2) stating that \$87,500 of the settlement was due to physical injury or physical sickness. Attached to the return was a letter from an attorney stating his reasons for considering a large portion of the settlement as compensation for emotional distress.

Internal Revenue Code § 104 states:

Internal Revenue Code § 104 **Compensation for injuries or sickness.**

**(a) In general.**

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, **gross income does not include—**

- (1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;
- (2) **the amount of any damages** (other than punitive damages) **received** (whether by suit or agreement and whether as lump sums or as periodic payments) **on account of personal physical injuries or physical sickness**;
- (3) amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer);
- (4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of

section 808 of the Foreign Service Act of 1980;  
and

(5) amounts received by an individual as disability income attributable to injuries incurred as a direct result of a terroristic or military action (as defined in section 692(c)(2) ).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401 (a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee. **For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.** The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1) attributable to emotional distress. (Emphasis added.)

In her letter, the taxpayer presented her arguments as to why she felt a portion of the settlement she received in 2002 from a former employer should be compensatory damages for physical injury or illness even though the settlement stated the payment constituted general damages. The taxpayer questioned whether pregnancy and aborting a child to keep a job was physical injury or physical illness. She asked if the State of Idaho was required to accept her amended return after the IRS allowed the amended federal return to process and the federal refund to be issued.

During the years preceding 1999, the taxpayer enjoyed employment with an Alaskan fishing company (company) as a cook on a fishing boat. Most years, she worked two seasons and always returned to [Redacted], Idaho between seasons. At the end of the second 1998 season, the taxpayer discovered she was pregnant. She and her fiancé were joyful until the taxpayer started worrying

about whether or not the company would call her back for the next season, because it was rumored that women who were pregnant were not called back to work on the fishing boats.

In early 1999, the taxpayer's employer became aware the taxpayer was pregnant, and the company did not call her back for the spring fishing season. She had been replaced as the cook on the fishing boat.

At that point, the taxpayer felt she had to choose between her career and her child. Her excitement about having a baby dampened, because neither she nor her fiancé had medical insurance; and they could not afford to have a child. Furthermore, the taxpayer wanted to continue working for the company. The taxpayer chose to have an abortion – a decision she later regretted.

After the termination of her pregnancy, the taxpayer attempted to go back to work for the company in the same capacity as in prior years. However, the company did not rehire her for that season. With help of the Equal Employment Opportunity Commission, the taxpayer filed a lawsuit against the company.

From the time the company found out about the lawsuit up until the settlement was reached, the taxpayer and the company had a strained relationship. She tried working for the company again, but it did not work out. She became unemployed and her emotional state deteriorated further. During these trying times, the taxpayer and her fiancé ended their relationship, and she had an alcohol related single-car accident. She began psychological treatment and was diagnosed with Adjustment Disorder with Depression, Major Depression, and Post Traumatic Stress Disorder.

In January 2002, the taxpayer and the company reached an out-of-court settlement. The Settlement Agreement paying the taxpayer \$175,000 stated: "The payment constitutes general damages."

The Tax Commission recognizes the taxpayer's emotional distress likely contributed to her making poor choices that resulted in injuries and illness. However, the income she received from the company to settle her lawsuit against the company was not for physical injuries or physical sickness; it was for general damages. For income tax purposes, "...emotional distress shall not be treated as a physical injury or physical sickness." Pursuant to the IRS Code and Idaho tax law, the entire settlement is gross income during the year it was received.

The taxpayer's challenge to the Tax Commission's determination because the IRS accepted a different amount of gross income is without merit. Although the IRS allowed the amended federal return to be processed, the Tax Commission chose to audit the taxpayer's amended Idaho return prior to processing. The review resulted in the denial of the adjustment and the claimed refund. The Tax Commission and the IRS do not use the same audit selection criteria. In addition, the time allowed for examining the taxpayer's 2002 federal return has not yet expired. The IRS is not barred from auditing both the original and the amended federal returns at a later date.

The taxpayer has provided nothing that would suggest the Bureau's determination denying the reduction in taxable income claimed in the taxpayer's Amended Idaho Individual Income Tax Return for 2002 was in error. The taxpayer has provided nothing to support a finding that a portion of the settlement she received in 2002 is nontaxable income. The taxpayer has not met her burden of proof.

WHEREFORE, the Notice of Deficiency Determination dated January 30, 2004, is APPROVED, AFFIRMED, and MADE FINAL.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2004.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

CERTIFICATE OF SERVICE BY MAIL

I hereby certify that I have on this \_\_\_\_\_ day of \_\_\_\_\_, 2004, served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

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